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October 28, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

VIA HAND DELIVERY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

**Re: In the Matter of Rules and Policies on Foreign Participation in
the U.S. Telecommunications Market, IB Docket No. 97-142**

Dear Mr. Caton:

Telefónica Internacional de España, S.A. ("Telefónica Internacional") hereby submits supplemental ex parte comments in the above-referenced proceeding, responding specifically to AT&T's proposal to condition the existing and future resale authority of foreign-affiliated carriers on their foreign affiliates' compliance with the Commission's new mandatory benchmarks.^{1/} As discussed at length in Telefónica's initial and reply comments in this proceeding, imposition of benchmark conditions on a foreign-affiliated carrier's authorization would be both contrary to the public interest and unlawful.^{2/} This is particularly true with respect to resale authorizations. Such a condition is contrary to the public interest because it is both unnecessary and

^{1/} Comments of AT&T filed in IB Docket No. 97-142, 31-33 (July 9, 1997).

^{2/} See generally, Comments of Telefónica Internacional filed in IB Docket No. 97-142 (July 9, 1997); Reply Comments of Telefónica Internacional filed in IB Docket No. 97-142 (Aug. 12, 1997).

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anti-competitive. It is unlawful because it is unconstitutional and because it conflicts with U.S. obligations under the WTO Agreement.

A. AT&T's Proposed Resale Condition Is Contrary to the Public Interest

AT&T's proposal to condition the resale authority of foreign-affiliated carriers on their foreign affiliates' compliance with the Commission's mandatory benchmarks is patently contrary to the public interest, as it is both unnecessary and anti-competitive. As the Commission itself has recognized, there is simply no evidence that foreign-affiliated carriers with resale authorizations have engaged in anti-competitive price squeezes in the past. Nor is there any reason to believe that they will do so in the future, particularly now that accounting rates are going down. Indeed, contrary to AT&T's claims, far from having an incentive to engage in predatory pricing, foreign-affiliated carriers have every incentive -- financial as well as legal -- not to. In fact, the only practical effect that AT&T's proposal would have, if adopted, would be to stifle the already limited competition in the U.S. international services market to the direct disadvantage of U.S. consumers.

1. The Proposed Resale Condition Is Unnecessary

There is no question but that conditioning the resale authorizations of foreign-affiliated carriers on their foreign-affiliates' compliance with the Commission's benchmarks is unnecessary. Such carriers simply do not have the incentive to engage in an expensive, risky and illegal activity, particularly when they have very little to gain and everything to lose. This conclusion is based not only market reality -- AT&T provides no evidence that a foreign-affiliated carrier has abused its resale authorization by engaging in predatory pricing -- but also on market theory -- it would be irrational for foreign-affiliated carriers to engage in such a practice in the first place.

a. There Is No Evidence that Foreign-Affiliated Carriers Have or Will Abuse their Resale Authorizations by Engaging in Predatory Pricing

There is no evidence that foreign-affiliated carriers ever have or ever will abuse their resale authorizations by engaging in predatory pricing. As Cable & Wireless ("C&W") pointed out in its recent ex parte presentation, no one has proven or even alleged that a foreign-affiliated carrier has actually priced its resale services below cost in order to price squeeze its unaffiliated competitors.^{3/} Indeed, even AT&T

^{3/} Ex Parte Presentation of Cable & Wireless filed in IB Docket 97-142, 2 (Oct. 10, 1997).

has only alleged that such anticompetitive behavior is theoretically possible.^{4/} Significantly, if this behavior were going to occur, it would have done so when settlement rates were at their peak (and foreign-affiliated carriers could rely on the settlement funds to offset losses), not now when they are decreasing. Indeed, settlement rates have fallen a staggering 48% since 1987^{5/} and show every indication of continuing to fall -- a fact which demonstrates that predatory pricing is now diminishing as a threat.

This market reality has been reflected in the Commission's resale policy to date. The Commission has consistently recognized that the resale of switched services raises no significant risk of anticompetitive conduct, even on affiliated routes, provided that the reseller is not affiliated with the underlying U.S. facilities-based carrier.^{6/} This recognition has been reflected in the Commission's practice of readily granting resale authorizations to foreign-affiliated carriers. It would be as irrational as it is unnecessary to reverse this long standing Commission practice in order to address a problem which no one has proven even exists.

b. It Is Irrational for Foreign-Affiliated Carriers to Use Their Resale Authorizations to Price Squeeze Unaffiliated Competitors

There is a reason that there have been no allegations of predatory pricing by foreign-affiliated resale carriers: such behavior would be completely irrational. As Telefónica demonstrated in its reply comments in this proceeding, as long as carriers behave rationally, even a facilities-based carrier would lose money if it engaged in predatory pricing in the U.S. market under the "ideal" (if seriously flawed) conditions

^{4/} See GTE Telecom, Inc., DA 96-1546, 1997 WL 523440, ¶¶ 38-39 (rel. Sept. 16, 1996).

^{5/} FCC, *Accounting Rates For International Message Telephone Service Of the United States* 6 (Jan. 1, 1997).

^{6/} See Ex Parte Presentation of Cable & Wireless at 15 (*citing Regulation of International Common Carrier Services*, Report and Order, 7 FCC Rcd. 7331, 7335 (1992); *Market Entry and Regulation of Foreign-Affiliated Entities*, Notice of Proposed Rulemaking, 100 FCC Rcd. 4844, ¶ 72 (1995); *Foreign Carrier Market Entry Order*, 11 FCC Rcd. at 3927; and *Foreign Participation NPRM* at ¶ 31)).

posited by Professor Lehr in his affidavit.^{7/} Such losses would be even larger for resale carriers whose costs are higher and whose settlement revenues are lower.

As C&W points out, Professor Lehr's model is particularly flawed with respect to resale services.^{8/} Professor Lehr assumes that resale carriers engaged in predatory pricing will incur the same amount of losses, and operate with the same costs, as their facilities-based counterparts.^{9/} This is not the case for two reasons. **First**, resale carriers do not, as do facilities-based carriers, qualify for return traffic from their foreign affiliates. Thus, they cannot use such return traffic to mitigate the losses incurred from predatory pricing. **Second**, resale carriers who use predatory pricing to increase the traffic flows on a given route will end up increasing their own costs. This is because the increased traffic will increase the net settlement payments of the underlying facilities-based carrier, who would respond by passing the increase on to its resellers. Clearly, no rational reseller faced with these circumstances would engage in predatory pricing.

Even if the economic disincentives were not enough to deter a foreign-affiliated reseller from engaging in predatory pricing, the risk of detection and prosecution would be.^{10/} A reseller's predatory pricing strategy would be easily discerned from the quarterly traffic and revenue reports proposed in the NPRM.^{11/} Additionally, the reseller's underlying facilities-based carrier would know the reseller's costs (except variable retail costs), and would have the ability and incentive to monitor the reseller's pricing decisions. Thus, it is highly unlikely that predatory pricing would go undetected. This likelihood of detection is in itself a deterrent not only because of the sanctions that the FCC could impose, but also because such predatory pricing

^{7/} Reply Comments of Telefónica Internacional filed in IB Docket No. 97-142, 18-21 (Aug. 12, 1997). See also Ex Parte Presentation of Cable & Wireless at 12-15 (analyzing the flaws in Professor Lehr's assumptions).

^{8/} Ex Parte Presentation of Cable & Wireless at 7-8.

^{9/} Lehr Affidavit at Exhibits 2 and 3.

^{10/} See Ex Parte Presentation of Cable & Wireless at 7.

^{11/} *Foreign Participation NPRM* at ¶¶ 98-101.

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would be subject to prosecution under the U.S. antitrust laws.^{12/} In other words, the risks are too high for a reseller to engage in behavior that would be unlikely to bring any long term benefits in the first place.

In short, a reseller acting in its own best interests would not engage in predatory pricing at all. Instead, its ideal strategy would be to price just above cost. Such a pricing strategy would ensure that it both underprices AT&T (who operates with huge margins) and earns a reasonable profit. This is precisely what AT&T fears. It is also precisely what the Commission should be encouraging in order to bring more competition and lower prices to U.S. consumers.

2. The Proposed Resale Condition Is Anticompetitive

Not only is AT&T's proposal to condition the resale authorizations of foreign-affiliated carriers unnecessary to prevent price squeezes, but it would also directly harm U.S. consumers by squashing competition in the U.S. international services market. As the Commission itself acknowledged in the *Benchmarks NPRM*, there is currently only "limited competition in the [U.S.] IMTS market."^{13/} By conditioning the current and future resale authorizations of foreign-affiliated carriers, the Commission will ensure not only that competition in this market does not expand, but that it actually shrinks. The result: higher prices and fewer choices for U.S. consumers.

Under AT&T's proposal, many foreign-affiliated resellers would no longer be able to service their affiliated routes. As a result, they would lose existing customers and would be unable to add new ones. The reseller will be forced to significantly scale back its operations, making it harder to provide the full panoply of services demanded by customers today. Indeed, it may even be forced to exit the market. Additionally, as the Commission itself has recognized, both existing and potential resellers would be harmed by the financial and market uncertainty created by the imposition of a condition, such as this one, which threatens to suspend a license on

^{12/} See Ex Parte Presentation of Cable & Wireless at 11 (citing *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 101, 117 (1986); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *International Telephone and Telegraph Corp.*, 104 F.T.C. 280, 423 (1984)).

^{13/} *Benchmarks NPRM* ¶ 9.

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the occurrence of a certain event.^{14/} Such uncertainty could not only deter foreign entry, but could also discourage foreign administrations from opening their own markets.^{15/}

As a result of reduced service offerings by foreign-affiliated resellers, consumers will be forced to look elsewhere to meet their needs, which may involve less favorable terms and conditions. Indeed, with fewer resellers in the market, and the threat of new competitors significantly diminished, AT&T will be free to maintain or even raise its high margins at the U.S. consumers expense. Such a result is contrary to both the Commission's pro-competitive goals in this proceeding and to its mandate to serve the public interest.

B. AT&T's Proposed Resale Condition Is Unlawful

AT&T's proposal to condition the resale authorizations of foreign-affiliated carriers on their affiliates' compliance with the Commission's benchmarks is unlawful because it both violates the Constitution and conflicts with U.S. treaty obligations under the WTO Agreement.^{16/} It is unconstitutional because it violates the equal protection component of the Fifth Amendment and constitutes an unjustified and uncompensated taking. It conflicts with the United States' WTO commitments because it compromises the key GATS principles of market access, national treatment and most favored nation ("MFN") treatment. These serious flaws alone should deter the Commission from adopting AT&T's proposal.

1. The Proposed Resale Condition Is Unconstitutional

The proposed resale condition is unconstitutional, as it violates the Fifth Amendment's guarantee of equal protection by treating foreign-affiliated carriers differently from the similarly situated incumbent local exchange carriers ("LECs"). In two recent decisions, the Commission has not required incumbent local exchange carriers ("LECs") to have cost-based access charges in order to enter the inter-LATA

^{14/} See Ex Parte Presentation of Cable & Wireless at 4 (*citing fONOROLA Corp.*, Order on Reconsideration, 9 FCC Rcd. 4066, 4069-70 (1994)).

^{15/} *Id.*

^{16/} Additionally, as Telefónica argued at length in its comments in the *International Settlement Rate* proceeding, the Commission simply does not have the legal authority to adopt mandatory settlement rates. See Comments of Telefónica Internacional filed in IB Docket No. 96-261 (Mar. 7, 1997).

market.^{17/} This is despite the fact that these charges are astronomically (700%) above cost, making AT&T's concern regarding predatory pricing a much more significant threat in the domestic than in the international context.

The proposed resale condition clearly cannot meet the strict scrutiny standard required of classifications, such as this one, that are based on alienage. Under strict scrutiny, the challenged regulation must be the least restrictive alternative necessary to achieve a compelling governmental interest.^{18/} As demonstrated above, the governmental interest here, preventing predatory pricing in the international services market, while theoretically possible, is practically impossible -- making it much less of a risk than in the domestic market. Thus, it cannot possibly be construed as compelling. Moreover, the means proposed for achieving this perceived interest -- conditioning **all** foreign-affiliated carriers' resale licenses on the affiliates' compliance with mandatory benchmarks -- is indisputably the broadest alternative possible.

2. The Proposed Resale Condition Conflicts with U.S. GATS Obligations

Conditioning the resale authorizations of foreign-affiliated carriers on their foreign affiliates' compliance with the Commission's proposed benchmarks conflicts with the United States' commitments under GATS. As Telefónica Internacional demonstrated in its earlier comments, such a benchmark condition directly conflicts with U.S. MFN, national treatment and market access obligations.^{19/} Such a conflict cannot be avoided by denominating the condition a "competitive safeguard" pursuant to GATS Article VI. Any such safeguard cannot compromise key GATS obligations and must be proportional to the problem it seeks to address. Destroying the existing resale business of foreign-affiliated carriers and discouraging future foreign entry on the basis of misconduct that is only remotely possible cannot possibly be construed as a proportionate response.

^{17/} See *Application of Ameritech Michigan Pursuant to section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan*, FCC 97-298 (rel. Aug. 19, 1997); *Application of SBC Communications, Inc. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Oklahoma*, 12 FCC Rcd. 8685 (1997).

^{18/} *Bernal v. Fainter*, 467 U.S. 216, 219 (1984); *Graham v. Richardson*, 403 U.S. 365, 371-72 (1971); *Sugarman v. Dougall*, 413 U.S. 634, 642-43 (1973).

^{19/} Comments of Telefónica Internacional at 12-14. See also Reply Comments of Telefónica Internacional filed in IB Docket No. 96-261 at 10-22.

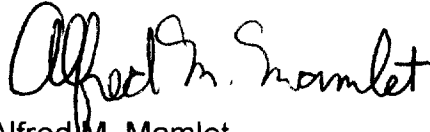
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For the foregoing reasons, Telefónica Internacional urges the Commission to reject AT&T's proposal to condition the resale authorizations of foreign-affiliated carriers on their foreign affiliates' compliance with the Commission's mandatory benchmarks.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Alfred M. Mamlet". The signature is fluid and cursive, with the first name "Alfred" being more prominent.

Alfred M. Mamlet

Colleen A. Sechrest

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